No. 12,308

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EDDY D. FIELD and HELEN FIELD,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

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TABLE OF AUTHORITIES CITED

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To the Honorable Judges of the United States Court of Appeals, for the Ninth Circuit:

The petitioners in the above entitled cause present this their petition for a rehearing of the above entitled cause, and, in support thereof, respectfully show:

I.

The opinion of the Tax Court of the United States which was affirmed and adopted by this Court is wrong for two reasons:

(1) The finding that the properties in question were held primarily for sale to customers in the ordinary course of taxpayer's trade or business is not supported by any evidence; and

(2) The Tax Court's conclusion of law is contrary to the law as subsequently announced by the Tax Court in the case of *Nelson A. Farry,* 13 T. C., No. 3, which latter decision has been acquiesced in by the Commissioner of Internal Revenue.

II.

Section 117(a)(1) of the Internal Revenue Code defines capital assets as "Property held by the taxpayer (whether or not connected with his trade or business)", with a number of exclusions. Of these exclusions, the one with which we are concerned herein provides that an asset is not a capital asset if it is

> *"property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."*

This exclusion from the category of capital assets, together with the closely related exclusions of stock-in-trade or property includable in inventory, helps to reveal the statutory design and intent of the Code decisions distinguishing between capital and non-capital assets. These exclusions apply to the property which a merchant carries for sale to the public, and the property which a dealer "holds for sale to customers." The sales so made are part of "the trade or business" of the taxpayer and are of a continuing or recurring nature. Profits resulting are of the same general nature as income from personal services, rent, dividends, and the like, and should receive the same treatment. On the other hand, an asset held by an "investor" is not held "primarily for sale to customers in the ordinary course of his trade or business." Such an investor usually holds property for the income which it produces or for long-term appreciation in value,

or both, and does not hold it for regular sales to customers. Assets so held by investors are capital assets.

This Court is well aware of the fact that this section of the Internal Revenue Code has produced much litigation, the reason probably being that the language of the statute itself is in general terms and of indefinite meaning. The phrase "primarily held" connotes uncertainty and the phrase "ordinary course of his trade or business" imports very little specific meaning by itself.

Section 117(j) of the Code was added by the Revenue Act of 1942 and is a remedial provision. Under its provisions the sale of real estate results in a Section 117(j) gain or loss even though it was used in the taxpayer's business if it was held for more than six (6) months, providing, however, that it was not held primarily for sale to customers in the ordinary course of taxpayer's business.

III.

In determining whether an asset is one held for investment or primarily for sale, it is submitted that it is important to know:

(1) How and why the taxpayer acquired the asset;

(2) What he did with it over a period of time; and

(3) How and why he disposed of it.

In this case the taxpayer sold eight pieces of property in 1943 which he claims were purchased and held as investment properties for rental income and upon which he reported the profit at capital gain rates. True in 1943 he sold seven other pieces of property which he held less than six months and upon which he reported the entire profit. This he had to do whether the properties were

capital assets or non-capital assets. The burden of proof of petitioners, however, was only to prove that the eight properties sold upon which the Commissioner denied capital gain treatment was erroneous. All of the properties but one had been held by petitioners for five to eight years. This one property had been held for a year and a half.

IV.

Petitioner had never held himself out as a dealer and his primary business was buying and selling properties for others on a commission basis. Petitioner, Eddy Field, testified that they organized a corporation in 1934 to hold properties which they were acquiring for investment. Their profits from the brokerage business were small but it was these profits that they used to purchase investment properties. Seven of the eight properties in question were so purchased and held by the corporation. The petitioner testified [Record p. 83] that in buying these properties they assumed very heavy loans and that from the rents from the properties they increased their equities, as well as by the profits of the brokerage business. One who is holding property primarily for sale does not ordinarily reduce the obligations against such property. Petitioner specifically testified that as to each of the eight properties involved they were purchased for investment and rental income and further explained that the reason for the sale of the properties in 1943 was

(1) as to seven of the properties, they were sold because petitioners had an opportunity to buy what they considered better investment property; and

(2) the other, that it had become an undesirable investment due to change in the neighborhood.

V.

Let us examine the Tax Court's opinion upon which this Court affirmed. The Tax Court says [Record p. 34]:

> "To ascertain whether petitioners were engaged during the taxable years in the business of selling real estate on their own account, we must examine all of the transactions during those years and not only those from which petitioners reported the profit as long-term capital gain."

It is submitted that this is not a correct statement of the law. It might be if all of the other properties sold were of the same type and purchased for the same reason as the eight in question, but no foundation was laid by respondent upon which that argument can rest. Petitioners' burden was to prove that the eight properties upon which they claimed capital gain were properties held for investment and rental income and not primarily for sale and if they proved that, that is as far as their burden went. That was exactly the problem before the Tax Court in the later case of *Nelson A. Farry, supra.* In that case the Tax Court held that the many sales of investment properties in the same manner as the properties which the taxpayers held primarily for sale to customers in the ordinary course of their trade or business, was not the determining factor with respect to the investment properties. Moreover, every investor who sells property sells for his own account. The fact that he sells for his own account does not convert a capital asset into a non-capital asset.

The Tax Court further says [Record p. 35]:

> "* * * We regard such a rapid turnover of properties, all at a profit, as inconsistent with the concept of investing in real property for the purpose of securing rental income."

The fact that all eight properties in question were sold at a profit is explained by petitioner [Record p. 75] where he said that the condition of the market in 1943 was such that any properties acquired six or eight or ten years before would have to show a gain. It would appear that the Court can take judicial notice of the fact that property bought in 1934, 1935 and 1936, as were these properties, were bought during a low market period, and that property such as those in question in 1943, a War year, in Los Angeles had a much higher market value. The eight properties in question had not been rapidly turned over. They had been held for several years and all of them were producing rental income, and taxpayer had increased his equities in those properties from the rentals received and from the profits of his brokerage business. Are not those uncontradicted facts consistent with concepts of investing in real property rather than holding those particular properties primarily for sale to customers?

The Tax Court further states [Record p. 35]:

> "That petitioner's reason for purchasing the eight properties in question are of little significance if the sales were so extensive as to establish them in the business of selling real estate on their own account."

It is submitted that that expression of the Court is exactly contrary to the later expression of the Tax Court in the *Farry* case, *supra.* It overlooks entirely the fact that a person may be an investor as to some properties, and hold others primarily for sale to customers. In that case the taxpayer was active in the sale of houses and lots in subdivisions which he had developed and he also held large numbers of low grade buildings for the rental income they produced. In 1944 and 1945 as a result of the land values and increased demand for housing he

decided to sell his rental properties. He sold nineteen in 1944 and twenty-seven in 1945. Most of them had been held for over a year, and some for as long as eleven years. The Commissioner contended that the profits from the sale of the rental property were taxable as ordinary income contending that petitioner was holding rental property primarily for sale to customers in the ordinary course of his trade or business. The Tax Court held that the profits had been properly returned as capital gains; that they had been bought and were held primarily for investment, and not for sale to customers in the ordinary course of business. The fact that the taxpayer was also a dealer in real estate was also immaterial. The Court, stating that if petitioner was holding the properties primarily for sale to customers they were not capital assets, said:

> "However, it seems to us that petitioner has proved by overwhelming evidence that he purchased and held these properties primarily for investment purposes. The fact that in the taxable years he received satisfactory offers for some of them and sold them does not establish that he was holding them 'primarily for sale to customers in the ordinary course of his trade or business.' The evidence shows that he was holding them for investment purposes and not for sale as a dealer in real estate."

The Commissioner of Internal Revenue acquiesced in the Tax Court's decision in the *Farry* case (see Prentice-Hall Federal Tax Service, Volume 4, 1950, No. 76, 216).

VI.

The respondent relied heavily in this Court and in the Tax Court upon the decisions of this Court in *Ehrman v. Commissioner,* 120 F. 2d 607, and *Richards v. Commissioner,* 81 F. 2d 369. They were also relied upon by the

Tax Court. It is submitted that those decisions are wholly inapplicable to the facts of this case. In the first place they both involve cases in which the taxpayers had subdivided tracts of land and sold many lots. Their only contention in this Court was that the sales were being made in order to liquidate the asset. All the Court held in those cases was that the motive of liquidation did not prevent the taxpayers from being engaged in a trade or business where they were actively subdividing, platting and developing property for sale. It is submitted that the decisions go no further than that.

Respondent relies upon the taxpayer's testimony in answer to some of the Court's questions [Record pp. 82-86] to the effect that in buying small properties they intended sometime to sell them when they were financially able to buy larger and better investment properties. The mere fact that a taxpayer buys a property for investment but admits that at some future date he will sell them either when he can realize a substantial profit or when he decides to dispose of them to buy a more desirable investment, does not mean that he is holding the property primarily for sale to customers in the ordinary course of his business. That is all the taxpayer testified to, namely, that he bought for investment properties because that was all he could afford to buy. He intended at some future date to own larger investment properties which would pay him better income and when he was able to do so, he would sell. It is submitted that that is what all investors do with investment property. They sell when they can better their investment and realize a profit. It does not follow it is respectfully submitted that just because they intend at some future time to dispose of them that they are holding

them "primarily for sale to customers in the ordinary course of their trade or business."

Petitioners agree with that part of the Tax Court's opinion in which they state [Record p. 36]:

> "How a taxpayer may invest his profits would seem to have little bearing on the question of whether or not he is engaged in a trade or business."

However, it is evidence of why petitioners sold their investment properties which they had held for several years. They sold them just to secure better investments, which is what every investor does, if he can.

VII.

Reflection will show the inequity of the Court's determination. It was testified, and there is no contradiction, that these eight properties were purchased by petitioners over a period of years from their surplus earnings in the brokerage business. Those surplus earnings represented their annual savings from this business; they invested in real estate; they held the real estate seven or eight years; they used the rents to increase their equities; then in 1943 they sold them. The monies which petitioners had in these eight properties represented their savings or investments. Whatever profit was realized on their sale was not an appreciation of value in 1943 but an appreciation in value over the period of time they were held. That is the very reason for the capital gain provisions of the Code, namely not to tax at 100 per cent the profits on investments which represent an appreciation over a period of time. Congress has seen fit to make that period in the current law six months. Previous Acts had fixed the time at eighteen months and two years. In other words, the result of the Court's decision is to tax petitioners in 1943 on

100 per cent of the profit they have made on their savings. Had petitioners invested their earnings in stocks or bonds and sold them in 1943 the Respondent would have determined they were sales of capital assets. Real estate is as much a capital asset under the Statute as are stocks and bonds.

Petitioners think it appropriate to state that the decision of this Court affirming the Tax Court in this case leaves the law in this Circuit unsettled. Petitioners' counsel is advised by responsible Bureau representatives that there are very many cases of the same kind which were being held up for settlement pending the decision of this Court in this case; that as a result of this Court's opinion in the case at Bar the law in this Circuit is unsettled. Taxpayers with similar cases are relying upon the Tax Court's opinion in the *Farry* case, *supra,* in which the Commissioner has published his acquiescence. On the other hand, the Commissioner can rely in this Circuit at least on this Court's decision in this case.

VIII.

Petitioner was the only witness. Respondent offered no evidence. He testified positively that he had never held himself out as a dealer in real estate; that he purchased the eight properties here in question out of his earnings as a broker and invested those earnings in the properties in question; that he bought them for investment and rental income; that he applied the rents against the encumbrances to increase his equities; that he held them for a period of several years: that none of his employees in his brokerage offices had anything to do with the sales of the properties in question, from which it may be assumed that they were not listed by him for sale and that he only sold them in 1943 to purchase properties which he

regarded as better investments. He likewise testified positively [Record p. 58] that he never held these properties primarily for sale to customers in the ordinary course of his business. His testimony was unimpeached and was not contradicted by the testimony of any other witness or by any other fact actually proved and is not inherently improbable. Petitioners are not asking this Court to resolve in their favor two conflicting theories each theory having some evidence in the record to sustain it, but is asking this Court to make the only finding it is possible under the uncontradicted evidence to make, namely, that the eight properties in question were held by the petitioners for investment and rental income and were not held primarily for sale to customers in the ordinary course of trade or business. This Court held in the case of *Grace Bros., Inc. v. Commissioner,* 173 F. 2d 170 at 174, that it is axiomatic that uncontradicted testimony must be followed, the only exception being where we are dealing with testimony by witnesses who stand impeached and whose testimony is contradicted by the testimony of others or by physical or other facts actually proved, or with testimony which is inherently improbable.

Wherefore, upon the foregoing grounds, it is respectfully urged that this Petition for a rehearing be granted, and that the decision of the Tax Court of the United States be upon further consideration reversed.

Respectfully submitted,

GEORGE BOUCHARD,
Counsel for Petitioners.

Certificate of Counsel.

I, George Bouchard, Counsel for the above-named petitioners, do hereby certify that the foregoing Petition for a rehearing of this cause is presented in good faith and not for delay.

Dated: March 27, 1950.

GEORGE BOUCHARD.